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No. 90-293

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

WHEREHOUSE ENTERTAINMENT, INC. et al.,

Petitioners,

—v.—

MCMAHAN & COMPANY, et al.,

Respondents.

REPLY MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioners submit this reply brief in further support of their petition for certiorari in this action.

Argument

In response to this Petition the Respondents argue that "the decision below stands only for the proposition that the emphasis upon and manner of presentation of the 'optional tender' in the Wherehouse prospectus and in oral statements could mislead investors" (Resp. Br. 8-9). Respondents thereby suggest that the decision below has no ramifications for other cases.

However, the "manner of presentation" of which Respondents complain is, in fact, nothing more than a virtually ver-

batim recitation in the prospectus of the "optional tender" provision in the indenture governing the rights of debentureholders; and the "oral presentation" of which they complain is an alleged statement by an underwriter that the "optional tender" provision in the indenture is a "protective covenant". To hold, as a divided panel of the Court of Appeals did, that such allegations constitute a valid cause of action under the federal securities laws is to open a Pandora's Box.

In particular, if a verbatim recitation of contractual rights is deemed insufficient under the federal securities laws, the only possible remedy would be to require issuers to provide legal analyses of the parties' contractual and common law rights. In a revealing footnote, Respondents themselves concede this point, by characterizing this case as concerning "the proper disclosure of a legal construct" (Resp. Br. 10 n.3). Until now, the federal courts have not considered "legal constructs", such as a recitation of the fiduciary duties of directors, to be "facts" that must be disclosed. To conclude otherwise, as the Second Circuit has done here, drastically expands the federal securities laws and poses a direct conflict with decisions in other Circuits, which have consistently held that legal "constructs", conclusions and analyses are not "facts" that must be disclosed under the federal securities laws. *See* Petition, Point II.

Respondents' attempt to equate this case with *Harris* v. *Union Electric Co.*, 787 F.2d 355, 364 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986) (Resp. Br. 9), reveals the fallacy of their argument. In that case a prospectus pertaining to the sale of debentures was held to violate the federal securities laws because it failed to disclose the existence of particular indenture provisions. Those provisions were particularly significant because they contained loopholes through which the issuer could circumvent the restrictions contained in provisions of the indenture that were disclosed. Clearly, the undisclosed indenture provisions in *Harris* were material facts whose non-disclosure rendered misleading the statements which were made in the prospectus about the indenture. Here, by contrast, all pertinent provisions of the indenture

were disclosed verbatim; all that is claimed to be "missing" are legal "constructs", analyses, and conclusions.

Respondents deny that the decision of the Court of Appeals would impose liability for failure to use pejorative labels to describe objective facts (Resp. Br. 9); yet Respondents' entire case, and the decision below, revolve exclusively around the issue of subjective labels. Thus, the alleged oral "misrepresentation" of which Respondents complain is the supposed comment of the underwriter of the debentures that the "optional tender" provision was a "protective covenant"; and their chief complaint about the prospectus is that it allegedly portrayed this provision "as an important right", and failed to describe that provision as "neither an option nor a requirement" (Resp. Br. 9-10). What plaintiffs are complaining about, and what the Second Circuit panel held constituted a viable cause of action under the federal securities laws, is that the underwriter allegedly used the "wrong" label, and that the prospectus did not include the "right" label, such as "illusory" or "meaningless" (Resp. Br. at 10, 11, 14), to describe the "optional tender" provision. Thus, the decision below squarely contradicts decisions of other Circuits that hold that subjective characterizations cannot be the basis of a claim under the federal securities laws. (*See* Petition, Point I).

In the same vein, Respondents argue that it is mere "happenstance" that one of the issues involved in *Virginia Bankshares* is whether the use of the term "independent" to describe an investment banking firm constituted a misstatement of "fact" for purposes of the federal securities laws. This is no "happenstance"; for the exact same issue is presented here: whether it was misleading for the prospectus to use the indenture's term "independent" to refer to the non-management directors whose votes would determine whether the optional tender provision would be triggered.

Respondents argue that the Court of Appeals held that the prospectus "implied" that these directors would represent the interests of debentureholders, rather than shareholders (Resp.

Br. 11). However, Respondents gloss over the fact that this "inference" was drawn solely from the prospectus' use of the indenture's term "independent" to refer to these directors. Thus, the issue here is precisely the same as in *Virginia Bankshares*: can a disclosure document containing all objective facts nonetheless violate the federal securities laws simply because it uses the label "independent"?[1]

Respondents also contend that certiorari should be denied because the decision below does not put an end to the case, but simply reinstates claims that had been dismissed by the District Court (Resp. Br. 8 n.3). That factor, while sometimes relevant, is no bar to review where, as here, the decision below adjudicates legal issues fundamental not only to further proceedings in this case, but in other cases as well. This Court has on numerous occasions granted certiorari to review significant non-final adjudications. *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982) (certiorari granted to review a decision of a court of appeals reversing a grant of summary judgment by the district court, which had dismissed a claim under § 10(b) of the Securities Exchange Act); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 165 (1976) (same); *Land, Chairman, United States Maritime Commission* v. *Dollar*, 330 U.S. 731, (1947) (after the district court dismissed the complaint and the court of appeals reversed, this Court granted certiorari, noting that "[a]lthough the judgment was not a final one, we considered it appropriate for review because it involved an issue 'fundamental to the further conduct of other cases' ").

Certiorari is appropriate here not only because petitioners in this case are exposed to a lengthy trial and possible judgment based on a fundamentally flawed decision, but because the principles underlying that decision are inconsistent with rulings in other Circuits and are certain to have a major

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1 In fact, this case presents the issue in even starker terms than *Virginia Bankshares* because here the indenture provided an explicit definition of the term "independent director", which was fully disclosed in the prospectus and which refutes the inference the Court of Appeals held could be drawn.

impact on pending and future claims under the federal securities laws.

Conclusion

For the reasons stated above and in Petitioners' original petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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